

Long-Range Plan, the MSRB determined to conduct a review of the rule's requirements and seek comments on whether there are compliance concerns to address. Although the MSRB is sensitive to the burden imposed on brokers, dealers and municipal securities dealers ("dealers") by the requirements of rule G-37 and is committed to reducing this burden whenever possible, the MSRB believes that the rule has provided substantial benefits to the industry and the investing public by reducing the direct connection between political contributions to issuer officials and the awarding of municipal securities business.

### Background

Rule G-37 prohibits a dealer from engaging in municipal securities business<sup>2</sup> with an issuer within two years after certain contributions to an official of such issuer made by the dealer, any municipal finance professional ("MFP") associated with such dealer (other than certain *de minimis* contributions)<sup>3</sup> or any political action committee ("PAC") controlled by the dealer or any MFP. In addition, the rule requires dealers to disclose on Form G-37/G-38 certain contributions to issuer officials and payments to political parties of states and political subdivisions made by MFPs and certain other categories of contributors. Rule G-8, on books and records, requires dealers to create records of such contributions and payments. Finally, rule G-37(i) provides a procedure whereby dealers may request that NASD or the appropriate regulatory agency (*i.e.*, federal bank regulatory authorities) grant an exemption from rule G-37's two-year ban on municipal securities business with an issuer that resulted from political contributions made to officials of that issuer.

### Review of Proposed Rule Change

#### *Exemption Process and Withdrawal of Certain Rule G-37 Questions and Answers*

As noted above, under rule G-37(i), a dealer that has triggered the rule's two-

year ban on municipal securities business may seek an exemption from that ban from the appropriate regulatory agency.<sup>4</sup> The rule provides that the appropriate regulatory agency may exempt, "conditionally or unconditionally," a dealer that is banned from engaging in municipal securities business with an issuer from such ban. The MSRB specifically intended that the regulatory agencies have flexibility in dealing with the various factual situations that may arise pursuant to exemption requests. For example, a regulatory agency could reduce the ban on business from two years to a lesser period of time. In determining whether to grant an exemption request, the appropriate regulatory agency is required to consider, among other factors, whether an exemption would be consistent with the public interest, the protection of investors and the purposes of rule G-37. The regulatory agency also is required to examine whether the dealer had appropriate procedures in place to ensure compliance with the rule, had no actual knowledge that the contribution was being made, has taken all steps to obtain a return of the contribution, and has taken any other appropriate remedial or preventive measures.

The Proposed Rule Change includes the addition of the following relevant factors to be considered by the appropriate regulatory agency in determining whether to grant an exemption (conditional or unconditional) from the two-year ban on business:

- The nature of remedial or preventive measures directed specifically toward the contributor and all employees of the dealer.
- Whether, at the time of the contribution, the contributor was an MFP or otherwise an employee of the dealer, or was seeking such employment.
- The timing and amount of the contribution.
- The nature of the election (*e.g.*, federal, state or local).
- The contributor's apparent intent or motive in making the contribution, as evidenced by the facts and circumstances surrounding such contribution.

The additional factors will help to clarify facts and circumstances relevant to exemptive requests and will facilitate the review of such requests by the appropriate regulatory agency. To further clarify and facilitate this process,

the MSRB also is withdrawing certain rule G-37 Questions and Answers ("Qs and As") previously published concerning when an exemption may or may not be appropriate. This action is necessary in order to clarify that the regulatory agencies have discretion in administering the exemption process. The Proposed Rule Change will assist the regulatory agencies in exercising their discretion in a manner that will fulfill the purposes of rule G-37.

#### *Adoption of an Automatic Exemption Provision*

The Proposed Rule Change provides for an automatic exemption from a dealer's ban on business in certain limited instances. This provision sets out procedures that would permit dealers to execute two such exemptions per 12-month period for contributions made by an MFP of \$250 or less if the dealer discovers the contribution within four months of the date of such contribution and the contributor obtains a return of the contribution within 60 calendar days of the date of discovery of such contribution by the dealer. A dealer would not be permitted to execute more than one automatic exemption relating to contributions by the same MFP. The automatic exemption would not be available for contributions made by a dealer, a dealer-controlled PAC or MFP-controlled PAC. Finally, dealers would be required to report the exemption on Form G-37/G-38 and to maintain records of such exemptions pursuant to rule G-8, on books and records. A dealer would be banned from municipal securities business until the contribution was returned.

The MSRB believes that a limited automatic exemption provision will provide a measure of relief to the industry without compromising the purposes of rule G-37. In addition, it will relieve some of the regulatory agencies' burden of administering the exemption process by removing from this process certain routine cases involving small contributions. The MSRB notes that the time periods proposed are reasonable and will encourage dealers to discover contributions that could give rise to a ban on business in a timely manner (*e.g.*, in preparation for the filing of quarterly forms G-37/G-38) and to seek quick refunds of these contributions. The automatic exemption will, for example, allow dealers who wish to hire as an MFP someone who previously gave a small contribution to an issuer official to lift the ban on business with that issuer after meeting the requirements of the new provision.

<sup>2</sup> Municipal securities business is defined in rule G-37 to encompass certain activities of dealers in connection with primary offerings of municipal securities, such as acting as underwriter in a negotiated sale, as placement agent, or as financial advisor, consultant or remarking agent to an issuer in which the dealer was chosen on a negotiated basis.

<sup>3</sup> Contributions made by an issuer for whom the MFP is entitled to vote will not cause the MFP's dealer to be prohibited from engaging in municipal securities business with issuer if the contributions, in total, are not in excess of \$250 by such MFP to each official of such issuer, per election.

<sup>4</sup> The appropriate regulatory agencies include NASD for securities firms and the federal bank regulators for bank dealers.